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Economic Conditions
Governmental Finance
United States Securities

New York, October, 1938

General Business Conditions

THIS issue of our monthly Letter has had to be prepared during a time when the menace of a European war has overshadowed all other influences upon the business situation, but as we go to press the crisis is receding, and the indications are happily for peace. To men with memories of 1914-18 it has seemed unbelievable — in the words of Mr. Chamberlain, fantastic and horrible — that the indescribable tragedy of those years, from whose aftermath the world is still suffering, could be repeated within a generation; and everywhere men have clung to hope that peaceful negotiation would dissolve the crisis. The Munich conference justified that hope; it gave a reprieve after days during which nearly every avenue to peace seemed closed, and the news that it has produced an agreement has been received here and abroad with thanksgiving.

It should be unnecessary to say that, apart from the human suffering caused, war is the greatest shock to the economic system that can possibly be experienced. War is an anachronism in civilization, for the essence of civilization is the friendly association of people and their cooperation for common progress and welfare. War ruthlessly disorganizes this cooperative system. It throws the complex industrial organization out of balance, and disrupts the relationships upon which trade is carried on. It withdraws men from mutually helpful and productive work and turns them to waste and destruction. It raises the demand for some goods to abnormal volume, and reduces the market for others. It closes outlets to some exporters and opens them to others. It blocks sources of supply to importers, interferes with transportation, and raises costs. Painful adjustments must be made to these changes, to put the industrial organization on a "war basis"; and after this has been done the adjustments necessary to get back on a peace basis may be even more difficult and depressing.

Moreover, economists are concerned not only with the disruption of the producing and distributing organization, but with the financial effects of war. A great war would pile upon the armament expenditures which Europe is already making an additional profligate waste of labor, capital and resources, for maintenance of forces in the field and production and destruction of material. It would add to debt, diminish the world's store of savings, and break down monetary systems. The world needs no fresh illustration of the financial disorder which follows war, for the aftermath of the last conflict is known through personal experience by most men of today. The great depression was the result of war, and it is a part of everyone's experience.

Effects of the Crisis Here

That the crisis has shocked business in this country goes without saying. In the markets the trade and industrial reports have counted for little as compared with the shifting international situation, and business men have watched with increasing anxiety the wavering balance between war and peace, the declines in securities and foreign currencies, and the other evidences of strain. In quarters where new financing or other plans for going ahead with business projects were under consideration the tendency has been to delay. At the same time, business men have been trying to foresee where the situation might involve them in difficulty or loss; and the measures taken to protect themselves, requiring caution in commitments and liquidation of positions which had become risky, necessarily tend to be depressing.

Opinions have differed as to the degree of disturbance that a European war would cause in this country. Some trades would have greater activity as time went on, but others would lose, and no one can foretell what the net result would be, at least during the period of adjustment to meet the war conditions.

Nor can anyone say what volume of selling the security markets might have to absorb. Europeans have large security holdings and short-term balances here, but our business is in an uptrend, the dollar is exceedingly strong with a favorable balance of payments and cap-

ital flowing this way, and it is buttressed by more than $13,700,000,000 of gold, a figure far greater than would be needed to pay out any sum which could conceivably be withdrawn from this country. Moreover, banks have three billions of excess reserves and payments of foreign balances could be made without credit stringency.

Most important of all, Europeans do not want their money home, but in the United States. The flight of capital from Europe here during the crisis has been on a scale almost without precedent, leading to the importation of more than half a billion dollars of gold in about two months. People sending their money here in such amounts and at such a time evidently will want to keep it here. Hence there should be less reason for widespread liquidation of investments such as happened in 1914.

War "Prosperity" Illusory

It is argued by some that because of foreign purchases of American products this country would be benefited by a war in which it was not involved. Of course a large volume of war orders would increase industrial activity and employment, absorb greater quantities of industrial materials and farm products, and probably cause a rise of prices. If the orders were great enough they would produce a boom.

However, assumptions as to the demand should not be too confident. There is no certainty as to how much foreign countries would want to buy from us, what they could pay with, and how much we would sell them. This country has the Neutrality Act, governing sales to countries at war; also the Johnson Act, under which the warring nations, as the situation now stands, could not borrow here. The effects of these Acts would have to be considered. Who can say when war business would offset the trade and financial disturbance upon which the markets have so far, and correctly, placed their emphasis? As to an inflationary boom, there is a great slack of unemployed labor, plant capacity and resources to be taken up before it could be generated.

In last analysis the answer to the argument that the United States might be benefited is that, even if temporarily correct, it is shortsighted, for reasons already touched upon. Gains of the industries at the expense of foreign competitors may not be permanent, and in the long run may be costly if over-expansion is induced, for this invites subsequent depression. A war boom is not real prosperity, for war destroys and depreciates real wealth, and the appearance of riches is an illusion, caused by depreciation of money.

Those who have thought that war would benefit this country should logically be depressed by the peaceful settlement, and look for a business setback; but they are evidently in a minority, for the markets have responded enthusiastically to the results at Munich.

The Domestic Situation

Under other conditions, the European crisis might have caused a considerable setback in business activity in this country. Up to the present, however, trade and industrial production have shown fewer effects than might have been expected. Business was in an upswing, it was moving forward under good headway, and its momentum has supported it against the growing hesitation.

Considering the month as a whole, the trade and industrial turnover in most lines has been well sustained, and most of the familiar indexes of business activity are higher than they were a month earlier. The Federal Reserve index of production made almost as good a rise in August as it did in July, the figures for three months being 77 for June, 83 for July and 88 for August. According to preliminary data September will show another though doubtless a smaller increase.

Even without the alarms of the past month, irregularities in business were to be expected. The index above quoted shows that the improvement in production, as in the markets, was rapid at the start; and considering all the complexities the rise would normally slow down after the first spurt. In many lines inventory liquidation is still going on, and buying policies are conservative for that reason, also because the experience of 1937 is well remembered. The other side of the matter is that a moderate rate of improvement will keep stocks and commitments in good order.

Whether the upward trend is sustained or blocked by the foreign situation, the resistance of business to shock and disturbance tends to strengthen confidence. It may be taken as a demonstration of needs for goods and of increasing ability to satisfy them; and these are fundamental, calculated to carry business forward if the European crisis ends in peace.

Retail Trade Improves

It was said in this Letter last month that many business men were waiting for September to give further confirmation that a genuine upward turn had been made; and that they were hoping for good reports from retail trade, a good reception of new automobile models, and reasonably firm and active markets. The month has been a disappointment in the last respect but not in the first. It is too early to judge the automobile situation, and in some manufactured lines reports say the pickup is less than hoped for, which may be a reflection of the European situation or of natural irregularities. On the credit side the month shows good building reports, continuance of the pickup in machine tool business, and steadier farm prices.

Retail trade made encouraging gains in the first two weeks of September, when the weather favored the sale of Autumn goods.

Department store sales figures collected by the Federal Reserve Board improved to around 5 per cent below a year ago, compared with decreases of 10 to 14 during most of the Summer. These gains have not been fully held, due partly to less favorable weather, but they brought a prompt pickup of orders at wholesale. Retailers on their earlier trips to the markets had bought sparingly, with the intention of reordering as necessary.

Conditions in the Industries

The automobile manufacturers have been changing over from 1938 to 1939 models during September and production figures for the month will be low, possibly no greater than the 97,000 assembled during August. However, a dozen or so companies are in production on new models as the month closes, and with Chevrolet almost ready October output will take a big jump. The new models are reported to be attractive, and priced a little lower. The Summer sales spurt, together with the early close of 1938 operations, has cleaned up dealers' stocks thoroughly, and the industry's advance ideas of next season's business have tended to expand, as compared with a few months back. Predictions range from 3,000,000 cars to as high as 3,500,000, and the average of that range is nearly 25 per cent better than the season just ended.

Steel operations have made further gains, to above 47 per cent of capacity; but in the last week of the month there was a slight drop and new business has been disappointing. Nevertheless, confidence is expressed that as automobile takings improve and contracts for public projects are awarded the operating rate will rise. Current prices were reaffirmed for the fourth quarter except in railroad materials, which were reduced in line with the cuts made earlier on other products. The industry is still short of the operating level at which it can show a profit at present prices, and if it fails to reach that point during the Fall either prices or wages are likely to be up for revision.

The tire industry is one which is pointing strongly upward. Manufacturers' inventories at the end of August had been reduced by 28 per cent from the peak and dealers' stocks have been cut also. With larger original equipment demand in sight and better replacement business expected, due in part to the large number of two and three year old cars now on the road, tire manufacturers are expanding production sharply.

The Summer improvement in textile operations is being sustained. Deliveries of rayon yarn in July and August were the largest on record and have been high in September also, probably higher than they will be hereafter now that weavers are better stocked, but production has been stepped up substantially. The cotton mills consumed 27 per cent more cotton in August than in June, the low month, and operations are holding. New business, however, is at unprofitable prices. Woolen goods markets are between seasons but mills are operating on late Fall goods orders at the highest rate in a year. The forthcoming Spring season, late in opening, should be an improvement, in view of the reports of small stocks of clothing and increasing purchasing power.

Building Ahead of Last Year

Building contracts awards for the first half of September, while they declined more than seasonally from August, show good gains over the same month last year. Residential building was up 13.1 per cent, and gains in public works and utilities offset a drop in the "non-residential" classification. The total increase was 14.3 per cent. For 1938 to date total building is under 1937, but if the improvement made since Spring is maintained the loss may be made up. Figures of mortgages selected for appraisal by the Federal Housing Administration, as well as those accepted for insurance, continue high, though there is evidence of a slight slowing up of the latter.

While small home building has contributed chiefly to the residential activity, there are also important large operations under way. Plans for the Red Hook low-rental housing development in New York City were announced in the middle of the month. This project demonstrates what may be done under the program of the U. S. Housing Authority. Its cost is estimated at $12,000,000, $4,600,000 less than was originally provided for it, and the cost per room of $1,125, including land, overhead and carrying charges, is substantially lower than previous New York City projects. Mr. Alfred Rheinstein of the New York City Housing Authority says that the lower cost is a result of careful planning, cooperation of the building industry, and favorable markets.

The building industry is very important in this country. Its depression has been a great factor in the general depression; and although the improvement is modest, it is an encouraging element in all calculations as to the future. Rental values have improved this year despite the depression, and until recently building costs were declining. Foreclosures are decreasing substantially and lending institutions are steadily if slowly moving properties acquired through foreclosure. With general business at low levels it appears that building at last has become a supporting influence.

The European Crisis and the Dollar

As the political situation in Europe during September grew more alarming the flow of capital to the United States, begun in July, increased in volume and in the latter part of

the month reached proportions seldom, if ever, equalled. Not only was there a general movement of funds from foreign currency deposits and securities into dollars, but also a rush on the part of large holders of gold to sell on the London market with a view to shifting the proceeds to this country, more remote from the area of possible conflict. While the continued premium on gold coin abroad indicated an unabated demand on the part of small hoarders, under recent conditions the dollar rather than gold became the preferred haven for international refugee funds.

This panicky flight of capital, coinciding with merchandise trade balances running heavily in favor of the United States, intensified the pressure upon the exchanges and forced most of the leading European currencies to the lowest levels since the revaluation of the dollar in 1934. The conversion of funds into dollars affected particularly the pound sterling, both because the nervous capital was chiefly amassed in the London market, and because that currency has been under pressure from the British import trade balance. Moreover, the pound has lacked the support formerly created by the demand for gold for hoarding.

Quoted at $4.85½ at the beginning of September, the pound fluctuated violently during the month, reflecting the alternating hope and despair of a peaceful settlement of the war crisis, but losing ground steadily. By September 28 it had fallen as low as $4.60, rallying afterwards above $4.80 on the outcome of the Four-Power Conference at Munich. The French franc sank to a new low, at 2.58½ cents present U. S. standard — equal to 1.53 cents former standard—under pressure of a capital flight to which anxiety concerning the Government fiscal situation contributed. Pressed for funds for defense measures, the French Government again had to borrow directly from the Bank of France, raising the latter's temporary advances to the State to a new high record of 44,633,000,000 francs as of September 23. The sharp decline in the pound disturbed the relationship between the United States and Canadian dollar, the latter dropping to a discount of 3½ cents, but recovering subsequently. The Dutch guilder and the Swiss franc, which were under less strain on account of capital flight than was the pound sterling, broke away from the pound and moved independently during the last days of the month. Both currencies, prior to their separation from sterling, established new low levels against the dollar since October, 1936, at 53.95 cents and 22.35 cents respectively. As in the case of sterling, foreign exchanges generally recovered following the peace moves at the close of the month.

The Work of Exchange Funds

In the London gold market the price of bar gold rose to 147 shillings an ounce, a new high price in terms of sterling. Contrary, however, to the condition last Spring, this rise in the sterling price of gold was not caused by the demand for gold, but rather was a reflection of the weakness of sterling. On September 28, owing to the decline in the pound, the price in dollars dropped at the fixing to a low of $34.25 an ounce against $35 an ounce paid by the United States Treasury. While ordinarily a spread of this magnitude would have led to heavy private arbitrage operations, higher insurance rates increased costs, and in addition individuals and banks were reluctant to make commitments, due to fear of changes in insurance rates and possible embargo between the time of purchase of the metal and date of shipment. Consequently, much of the burden of supporting the exchanges and preventing complete collapse fell upon government exchange funds. In accordance with officially stated policy, the British Equalization Account has made no attempt to peg sterling, but has retreated gradually under pressure, seeking only to maintain an orderly market. By standing ready to buy gold at $35 an ounce, our Treasury has provided foreign governments with a supply of dollars needed to defend their currencies and avert the breakdown of the exchange market otherwise inevitable. Thus, it appears that gold is once more demonstrating its usefulness as a medium for international transfer and as a means of confining currency fluctuations within bounds.

It is worthy of note that central banks and governments, as well as private interests, have contributed to the movement of funds between international money centers. Thus, Belgium has been shifting part of its gold reserves to London. Ireland and Sweden repatriated a part of their reserves, while Sweden, Great Britain and probably other countries have been building up gold balances on this side of the Atlantic. It is impossible to know definitely the true meaning of these movements, but presumably the risks of currency depreciation (in the case of foreign exchange balances) and fear of air attacks or capture (in the case of gold) have been among the influential factors. Owing to the advance of war risk insurance rates, shipments of gold to London from South Africa have been suspended.

The London Money Market

The strain upon the London money market caused by the war crisis and the flight of capital is apparent from the following table. Short-term money rates more than doubled within a month and prices of British Government bonds as well as other securities experienced severe recessions, resulting in the establishment by

the authorities of restrictions upon trading. Following the more favorable turn of political developments late in the month prices of securities rallied briskly in London and in Continental markets.

British Financial Indexes
Weekly High and Low

Week Ending	Pound Sterling	2½% Consols	3 Mo. Bank Bills	Industrial Shares*
Aug. 5	4.91 7/8 -4.89	75 5/8-75 1/8	9/16	105.2-104.9
12	4.88 15/16-4.87 1/8	75 1/2-75 1/4	9/16	105.3-104.9
19	4.88 3/8 -4.87 1/8	75 1/8-75	9/16	104.1-103.4
26	4.88 7/16 -4.87 1/4	75 1/2-75 1/8	9/16	104.2-103.0
Sept. 2	4.87 3/16 -4.84 3/16	74 7/8-74 1/8	9/16	102.8 102.1
9	4.83 5/16 -4.81	74 -73 1/4	5/8 - 9/16	103.3-101.6
16	4.81 7/8 -4.79 3/8	72 3/4-69 1/2	1 -11/16	101.5- 97.9
23	4.83 3/16 -4.77 3/8	72 3/4-70 3/4	1 1/8-1	99.9- 97.8
30	4.84 -4.60	72 1/4-65	1 3/4-1 7/16	97.2- 91.2

*Financial Times.

Domestic Banking Conditions

Domestic banking statistics underwent large and important changes during September, owing both to the extraordinary gold inflow and to the influence of Treasury operations centering on the 15th. Due principally to the gold purchases by the Treasury, member bank reserves increased nearly $400,000,000 between the early part of August and the middle of September, reaching a new peak of $8,425,000,000 on September 14. Excess reserves, while increasing less rapidly than actual reserves because of the added reserve requirements of advancing deposits, rose approximately $200,000,000 during the period to an estimated $3,130,000,000, or close to the year's peak reached in July.

But for the absorption of funds from the market by the Treasury on and after the 15th, the rise of bank reserves would have gone further. At that time the Treasury collected the third quarterly instalment of income taxes and received payments by subscribers to $800,000,000 of new Treasury bonds and notes. The net effect of these transactions, after offsetting disbursements by the Treasury on account of public debt interest, gold purchases and other current obligations, was to increase markedly the Treasury's cash balance in the Federal Reserve Banks and to reduce member bank reserves by some $400,000,000. Inasmuch, however, as funds received by the Treasury will ultimately be disbursed the setback to reserves may be regarded as temporary. The fact of real significance is that the Treasury, according to latest reports, holds, in addition to its deposits in commercial banks, about $860,000,000 of deposits in the Reserve Banks, also (in the general fund) approximately $800,000,000 of gold not yet converted into spendable cash through the medium of gold certificates issued to the Reserve Banks. The eventual expenditure of these sums, now held outside the commercial banking system, promises in the course of time not only to restore reserves to their former maximum levels, but to carry them much beyond.

Late in September, when the inflow of gold was swelled rapidly by fears of war in Europe, the Treasury resumed the issuance of gold certificates to the Federal Reserve Banks in order to reimburse its cash account for the outlays resulting from gold purchases. During the preceding five months, the payments for gold purchased by the Treasury had been drawn out of its general fund balance. At a press conference, Secretary Morgenthau indicated that hereafter the Treasury would reimburse itself promptly for gold purchases, and might also utilize some of the gold now in the general fund to replenish any decreases in its cash balances, if necessary. By depositing gold certificates, the Treasury will be able to pay for gold without drawing funds out of the market and gold imports, therefore, will exert their full effect upon bank reserves.

Bank Credit Expanding on Government Borrowing

At the weekly reporting member banks, the principal feature, apart from changes in reserves, was a rise of over $350,000,000 in holdings of United States Government securities, reflecting mainly subscriptions to new issues on the 15th. Including these additions to portfolio, total earning assets on the 21st stood at $21,265,000,000, or $800,000,000 above the July low point of the year. Practically all of this increase was in investments, with holdings of United States Government issues accounting for $568,000,000 and miscellaneous securities $200,000,000. Loans in the aggregate showed little net change for the period, a rise that appeared to be getting under way in August petering out in September.

Advances to brokers and dealers in securities increased, as usual, prior to the Treasury financing, but declined afterwards. Commercial loans, after a promising upturn a month ago, have moved disappointingly, partly because of repayments in New York City, other cities making a somewhat better showing. It should be added, however, that there is frequently a considerable lag between the commencement of a recovery in business and the reflection of increased commercial operations in the loan portfolios of the banks.

Deposits of reporting banks increased during the period under review and on September 14 stood at the high of the year, approximately two billion dollars above the low reached in March. During the succeeding week deposits declined sharply, owing to tax collections and cash payments by individuals and corporations for new Treasury issues, but a recovery is anticipated as funds collected by the Treasury are paid back into the market. With the Government embarked upon a far-

reaching program of borrowing and spending, the continuation of an upward trend of deposits seems assured.

Indications both in the markets and in the bank figures are that capital fleeing to this country from Europe during the present crisis is going into bank deposits rather than into securities. According to statements of the reporting banks, balances due foreign banks have increased rapidly in recent weeks and on the 21st were up nearly $150,000,000 since the end of July. Deposits of foreign central banks with the Federal Reserve Banks increased $78,000,000 between August 17 and September 21, while the increase of deposits of foreign individuals and business concerns in the commercial banks, for which data are not available, evidently has been large.

Money Market Quiet; Securities Unsettled

With the supply of funds already far in excess of any conceivable demand, and gold imports adding further to the monetary base, the money market continued quiet and devoid of special feature. A slight stiffening in the sensitive discount rate on Treasury bills to 0.14 per cent compared with under 0.05 per cent in August, reflected, but in lesser degree, the same disturbed psychology that contributed to higher rates in the London market.

The security markets were nervous and unsettled, with prices closely responsive to European developments. In the bond market, prices of United States Government and other high grade bonds softened under the threat of war, but rallied strongly late in the month as conferences by heads of the leading European powers brought renewed hopes for peace. Trading throughout the month was orderly in character, and at no time were quotations on the better grade of domestic bonds seriously depressed. Prices of lesser rated domestic obligations were more sensitive and tended to fluctuate with the stock market. While the foreign list naturally experienced severe unsettlement, even the worst hit issues recovered substantially from the lows.

New financing dwindled sharply during the month, due to the disturbed conditions. While the volume of prospective issues is large, offerings are being held back pending clarification of the outlook, and no important commitments by dealers are reported as outstanding at the present time.

United States Treasury Finances

The reentry of the Treasury into the market in September for the first "new" money other than borrowings on bills and savings bonds since June 1937, plus the fact that September concludes the first quarter of the new fiscal year, makes timely a review of the financial position of the Government and of the progress of the spending-lending program.

When the President submitted his recovery proposals to Congress last April he called for additional appropriations for Treasury loans and expenditures for recovery and relief amounting to approximately $3,000,000,000, not including $1,500,000,000 increased lending capacity of the Reconstruction Finance Corporation already authorized, or a grand total of $4,500,000,000, of which $1,400,000,000 was to be financed by use of the proceeds of desterilized gold. To these recommendations Congress added approximately $750,000,000, raising the sum total of new emergency appropriations, including R. F. C., to $5,250,000,000.

In July the President announced new budgetary estimates, revising previous figures in the light of the spending program and of the falling off of receipts caused by the depression. According to the President's summation, the Treasury expects a net deficit (excluding sinking fund) for the fiscal year ending June 30, 1939, of slightly less than $4,000,000,000, as against an actual net deficit for the year just closed of somewhat less than $1,500,000,000. To finance this deficit it was stated that the working balance in the general fund would be reduced by about $500,000,000, while approximately $680,000,000 would be absorbed by social security and other government trust funds, leaving $2,800,000,000 to be financed in the market. It was indicated that the sale of savings bonds, which last year provided over $400,000,000, would reduce to below $2,400,000,000 the formal offering of new securities to the open market.

The September Financing

The raising of this sum of new money, plus the refinancing of over $2,600,000,000 of Treasury securities other than bills, has constituted a major problem facing the Treasury this year. By taking advantage of favorable money market conditions during the Summer and forepart of September to raise over $900,000,000 new money and refinance the September and December note maturities, the Treasury has made a good beginning on its financial program. As a consequence of the September financing, together with income tax collections, repayments by the R. F. C., and an expansion of bill sales in August, the Treasury's working balance in the general fund has been lifted above $2,400,000,000, or more than double the billion-dollar level generally regarded by the Treasury as a desirable minimum. Included in this working balance are holdings of approximately $800,000,000 of gold, representing largely gold purchased since April against which the Treasury has not yet issued gold certificates, around $860,000,000 of funds on deposit with the Federal Reserve Banks,

and approximately $800,000,000 of deposits in commercial banks. As against these funds, the Treasury has no maturities other than bills until next March when nearly a billion dollars of notes fall due.

Budget Receipts and Expenditures

For the first quarter of the fiscal year through September 27, 1938, revenue receipts totaled approximately $1,482,000,000, a decrease of $134,000,000 from the same period last year. The rate of decline is less than that estimated in the President's revised budget issued last July for the complete fiscal year, for the reason that the full effects of the falling off in business this calendar year will not be reflected in the corporate and individual income tax receipts until next March.

Expenditures to September 27 totaled $2,148,000,000, an increase of $259,000,000 over last year. The increase was caused principally by the larger expenditures for the Works Progress Administration, which are now running at the rate of nearly $200,000,000 per month—an all-time high peak.

Other phases of the "Recovery and Relief" program have experienced inevitable delays in getting under way, with actual expenditures during the first quarter not only far below the rate estimated for the full year but even below the expenditures of the corresponding period a year ago. For example, public works expenditures under this category (other than W.P.A.) totaled $79,000,000, against $108,000,000 last year, while under "General Expenditures" the outlay for public buildings ran behind last year, and that for public highways was only slightly above. Aid to home owners under "Recovery and Relief," including the Home Loan System, emergency housing, U. S. Housing Authority, Federal Housing Administration and Farm Security Administration totaled $32,000,000 this year, against $63,000,000 last year. Revolving funds for the Farm Credit Administration, and for public works loans and grants to States, municipalities, etc., show net advances of $27,000,000 this year against $45,000,000 last year. It is evident, therefore, that the acceleration of Government spending to date has been chiefly in the consumers' goods field, while that type of spending more directly concerned with the heavy goods industries has still to make its influence felt.

This year there have been increases in "General Expenditures" for departmental purposes, national defense, the agricultural adjustment program and social security, but transfers to trust accounts have been smaller. A condensed summary of the results to date is given on this page for reference, together with actual figures for the complete fiscal year 1938 and the revised budget estimates for 1939.

Condensed Summary of U. S. Government Finances, 1938-1939
(In Millions of Dollars)

	July 1 to September 27		Years ended June 30	
Receipts	1937 Actual	1938 Actual	1938 Actual	1939 Budget
Income tax	$ 587	$ 574	$2,635	$2,013
Misc. internal revenue	692	620	2,285	1,919
Social security taxes	160	166	755	592
Customs	112	77	359	278
Misc. receipts	65	45	208	199
Total receipts	$1,616	$1,482	$6,242	$5,000
Expenditures				
General				
Departmental & misc.	302	347	1,101	1,317
National defense	227	261	974	1,050
Veterans' Administration	143	142	582	544
Agricultural adjustment	46	117	362	700
Civilian Cons. Corps	91	79	326	275
Social security	57	81	291	338
Interest on public debt	186	172	926	976
Refunds	14	18	100	76
Recovery and relief				
Agricultural aid	13	16	170	38
Relief (W.P.A.*)	324	537	1,477	2,137
Public works	108	79	376	275
Aid to home owners	63	32	240	199
Revolving funds (net)	45	27	169	392
Transfers to trust a/c	241	227	607	568
Supplemental items**	....	....	....	100
Sinking fund debt retire.	28	13	65	100
Total expenditures	$1,889	$2,148	$7,766	$9,085
Excess of Expenditures				
Gross deficit	273	666	1,525	4,085
Deficit excl. debt retire.	245	652	1,459	3,985

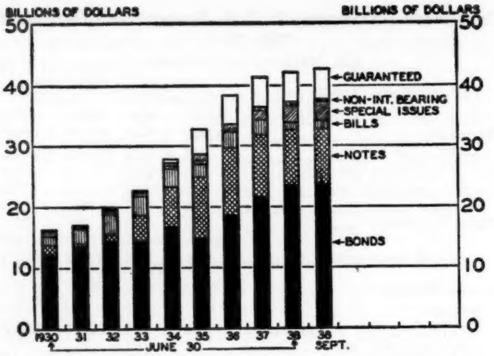
*Including National Youth Administration and miscellaneous relief. **Exclusive of $500,000,000 allocated to W.P.A.

On balance, expenditures for the period exceeded receipts by $652,000,000 so far this year, compared with an excess of expenditures of $245,000,000 a year ago. For the full year, the net deficit (without allowance for sinking fund) estimated at $3,985,000,000 will, if realized, establish a new high in the series of nine consecutive deficits since 1930, with the exception of 1936, when the soldiers' bonus was paid.

Changes in the Public Debt

After giving effect to the new financing last month, the direct public debt on September 27 totaled approximately $38,389,000,000, an increase of $1,225,000,000 since June 30, and a cumulative increase of $22,363,000,000 from the post-war low point on December 31, 1930.

Although the total debt is continuing to mount, it is of interest to note that the net increase for more than two years past has been financed entirely by the sale of long-term bonds and by "special issues" to social security and other trust funds, while at the same time the short-term obligations (other than special issues) have been worked down substantially. This changing character of the debt is shown in the accompanying chart, which gives the condition as of June 30 for each fiscal year from 1930 to 1938, with preliminary figures for September 30, 1939.



Composition of United States Government Direct and Guaranteed Debt.

The proportion of direct interest-bearing debt in the form of bonds and special issues has risen from approximately 58 per cent in June 1936, to 64 per cent in June 1937 and 72 per cent in September 1938, with corresponding reductions of the proportion of short-term debt in the form of notes and bills. No important note issue matures until next March, and the total of outstanding bills, which has been as high as $2,653,000,000, is now down to $1,304,-000,000.

With the working balance above $2,400,-000,000, and outstanding bills reduced, it is evident that the Treasury has placed itself in an unusually strong position to finance to a large extent from cash and short-term borrowing, plus proceeds from the sale of savings bonds, the spending-lending program for the balance of the fiscal year.

Contingent debt of the Government under the fully guaranteed bonds of its credit agencies (Home Owners Loan Corporation, Federal Farm Mortgage Corporation, Reconstruction Finance Corporation, etc.) is also shown on the chart, and on July 31, 1938 amounted to $5,100,000,000. In addition, the agencies have direct liabilities of $2,890,000,000 outstanding, (about two-thirds of which is represented by Federal Land Bank bonds), and also contingent liabilities under their guarantees (Federal Housing Administration mortgages, etc.), but as these obligations do not carry the guarantee of the United States, they are not shown on the chart.

The United States Cotton Problem

We quoted last month from an extended review of economic and social conditions in the South issued by the "National Emergency Council." The import of this review was that although the South is the richest section of the country in natural resources, it has a more serious poverty problem than any other. It is said to surpass any one section in variety of mineral wealth, and also to have a greater variety of soil products. Moreover, its cotton and tobacco crops have a greater per acre value than any other of the field crops. Nevertheless, the South's chief problem is in its agriculture. The present cotton situation primarily affects the South, but ultimately may affect northern agriculture and become a truly national problem.

One paragraph of last month's quotation from the Council's Report reads as follows:

> With 28 per cent of the nation's people, it has only 16 per cent of the tools with which people make a living; with over half of the country's farmers, the South has less than one-fifth of the nation's farm implements.

It is noteworthy that the showing of "tools" is much better for industry as a whole than for agriculture, and this accords with common knowledge. The cotton, woolen and rayon mills of the South are as well equipped as those of the North, and so of the pulp, paper, lumber, cement and steel mills, shoe and furniture factories, etc. On the other hand, agriculture in the South is largely devoted to cotton, for which but few and cheap tools are used. The rule everywhere is that workers aided by capital-equipment produce more than hand-workers, and get more pay, which also means that workers without such aid produce but little and get but little. Cotton is a wonderful crop, but possibly too many "hands" are needed to make it.

The South's Reliance Upon Cotton

The devotion of the South to cotton should be studied, and also the efforts of the Federal Government to "do something" for cotton. For a long time American cotton dominated world markets. In the years from 1865 to 1900 our exports of cotton averaged twice the home consumption, and competition in foreign markets was negligible; but the World War worked many changes, and has had lasting effects upon cotton and cotton goods.

The War and the boll weevil together raised cotton to an average of 38.3 cents per lb. in 1919-20, with a peak of 43¾ cents. Under the stimulus of high prices, our cotton acreage reached the high point in 1925-1926, in each of which years the plantings were about 46,000,-000 acres. The crop of 1925 was 16,123,000 bales, the largest on record, and the crop of 1926 was 17,755,000 bales, making a new record. Under the weight of the two crops the New York price broke to 12.2c, but with lower prices exports in the two crop-years aggregated 19,000,000 bales, and in 1928 the price rallied to an average of 20c. In 1929 the Federal Farm Board was established to support farm prices, and attempted to fix cotton at 18c, but the price declined to 8¼c in 1930-31, and when another 16,600,000 bales came in 1931 the price broke to a low of 5.3c.

In 1933 the Government's policy was changed to acreage restriction, and it bought and ploughed under 10,000,000 acres of growing

cotton. The 1937 crop was restricted to 34,500,000 acres, but perverse Nature gave a yield of 18,916,000 bales, another new record. The Government offered loans of 9c a pound on the crop, which supported the market, but it accumulated a stock of 7,000,000 bales, and this year the loans were reduced to the minimum permissable under the Farm Act, or 8.30c. The 1938 plantings were reduced under the allotment plan, by about 23 per cent, but the present farm price is the lowest since 1932. Moreover, there is talk of another acreage cut next year.

Meanwhile, the foreign crop has more than doubled from the average production of the four years 1921-24, and it may rise higher if the United States is successful in raising the price. No one familiar with the cotton trade doubts that if the United States is willing to sacrifice its own cotton production to raise the world price, it will have a measure of success; or doubts that by so doing it will continue to be a diminishing factor in the world supply. Competition cannot be met successfully by backing away from it.

Competition in Cotton

The following table shows the average yearly consumption of American cotton at home, in Great Britain, on the Continent of Europe, in the Orient and elsewhere, in five year periods from 1909 to 1934 and the last four crop years. The second part of the table shows the increasing consumption of foreign cotton since 1921:

Consumption of American Cotton
(000's of Running Bales)

5-Yr. Av.	United States	Outside U. S.	Great Britain	Continent	Orient	Elsewhere	Grand Total
1909-14	4,869	8,283	3,215	4,585	314	169	13,152
1914-19	5,980	5,946	2,748	2,425	572	201	11,926
1919-24	5,594	5,954	1,916	3,025	815	198	11,548
1924-29	6,457	8,317	2,006	4,718	1,342	251	14,774
1929-34	5,438	7,516	1,285	3,906	2,100	225	12,954
1934-38*	6,207	5,805	1,139	2,717	1,662	287	12,012

Consumption of Foreign Cottons
(000's of Bales)

5-Yr. Av.	United States	Outside U. S.	Great Britain	Continent	Orient	Elsewhere	Grand Total
1921-24†	322	8,093	1,113	1,661	4,712	607	8,415
1924-29	296	9,690	1,142	2,636	5,102	810	9,986
1929-34	177	10,959	1,162	3,548	5,487	762	11,136
Crop Yr.							
1935-36	130	15,075	1,541	5,167	7,264	1,103	15,205
1936-37	182	17,716	1,887	6,057	8,593	1,179	17,898
1937-38	140	15,360	1,560	6,280	6,320	1,200	15,500

* 4 year average. † 3-year average.
Source: Cotton Year Books of the New York Cotton Exchange.

First should be noted the declining consumption of American cotton in Great Britain, which at one time took the greater part of our exports. Note also the decline on the Continent, and the growing use of foreign cotton in Britain and on the Continent. The average annual aggregate consumption of our cotton in Great Britain and Europe in the five year period ended 1914 was 7,800,000 bales and in the four years 1934-38, only 3,856,000 bales, an average loss of 3,944,000 bales, or more than one-half the 1909-14 annual average.

As to foreign cotton, available reports do not go back of 1921, but in the three years 1921-24 the average yearly consumption by Britain and the Continent was 2,774,000 bales, and in 1936-37 was 7,944,000 bales, an increase of 5,170,000 bales. In the grand total column the American figures are lower in 1934-38 than in 1909-14, while foreign cotton is up more than 7,000,000 bales from 1921-24 to 1937-38.

Our loss of sales to Great Britain and the Continent was partially offset by gains in the Orient and elsewhere; but these gains cannot be counted as permanent. The showing of greatest significance is the increasing production of both cotton and cotton goods in the low wage countries of Asia, Africa and Latin America.

Cotton Goods Production

The rise of costs and prices in the cotton goods industries of Europe and the United States, caused by the war, gave a great stimulus to cotton goods production in countries that had been buying such goods in Europe or this country. The following table shows the change in the cotton goods exports of three countries, from 1913 to 1936:

Total Cotton Goods Exports
(In Millions of Square Yards)

	1913	1929	1935	1936
From: United Kingdom	7,075	3,671	1,948	1,917
Japan	211	1,790	2,725	2,710
United States	445	543	186	201

Source: Bureau of Foreign and Domestic Commerce

Both tables are chiefly significant of the rise of Japan as a producer and exporter of cotton goods. In 1930-31 it succeeded Great Britain as the largest purchaser of our cotton, but since then has been shopping for cheaper cotton.

For many years the United States was an exporter of cotton goods, to Asia, South America and around the Caribbean, the effect of which was to enlarge the home market for cotton. This trade has become negligible. The costs and prices of N.R.A. (1933-35) started an alarming stream of Japanese cotton goods into the United States. In 1935 President Roosevelt used his authority under the Hawley-Smoot act to raise import duties on these goods. Moreover, it cannot be forgotten that in December, 1936, the Cotton Textile Institute sent a Commission of five members, three of whom were representative of the South, to Japan, to request and urge the Japanese cotton goods manufacturers to limit their exports to the United States, and that the agreement thus obtained remains in effect today.

Furthermore, not only Japan, but many of the countries which once bought cotton goods from the United States, now are making cotton goods, and at much lower costs than they can be produced in the United States on the present wage and hour basis. Few, if any, of

these countries will conform to the wage and hours regulations adopted at Geneva, which now, in temporary and modified form, are incorporated in the Wages and Hours Act of the United States.

In fact, they cannot do so without applying similar regulations to all their industries, or completely disrupting their internal trade relations and causing unemployment on a great scale. They have not the capital equipment to shorten their work-time and still supply the things they need. A Japanese delegate to the Textile Conference in the United States last year frankly said that if textile wages in Japan were raised to a level with those in the United States, not much of the product could be sold in Japan.

Unless the voluntary Japanese agreement is made permanent, and similar ones obtained with other countries outside the Geneva compact, higher protective tariffs will be necessary to maintain the cotton-goods industry in the United States, on the present scale of costs. This, if last year's report of the Cotton Textile Institute Mission to Japan may be accepted.

It is not strange that some of our Southern friends, true to instinct and training, turn naturally to the protective tariff as the mother of iniquities, but we submit that the tariff is not the vital factor in the cotton problem. While it is true that trade relations with other countries require a two-way movement, the first condition of foreign trade is ability to meet foreign competition, in both quality and price. Our cotton is better in quality than most of its competitors, but the foreign quality is improving, and price may make up for quality. It is an old story that the per-acre-yield of cotton in this country might be better. Thousands of cotton-farmers produce above the average. It may be increased by better seed, better cultivation, more adequate use of fertilizers, or by new and improved machine equipment, as Northern farmers have cheapened grain production. It is not too much to say that two important gains are possible, viz: the quality of American cotton may be improved and the cost of production may be reduced.

Competitive Fibers Affecting Cotton

Not only is the production of cotton increasing in other countries, but the use of competitive fibers is increasing. We gave in our June number a brief account of the rapid development of rayon "staple" fiber, a new cellulose product, made from rayon and spun on cotton spindles. The development of cellulose products has created a great new branch of the textile industry, and is of growing importance in the South. At first they were thought lacking in strength, but have been improved until recently two leading makers of motor car tires have claimed that cellulose cord is a preferred material. Rayon or "staple fiber" is woven with silk, cotton or wool, and the weaves are popular goods. In the long run sales may be increased by the greater variety, but in some countries the use of cotton has been reduced. Italy, Germany and Japan are examples. Japan, which has been the largest buyer of American cotton, has now become the largest producer of "staple fiber," and recently has prohibited imports of American cotton, except for use in exported goods. Her home consumption for a population of 70,000,000 is restricted to wood fiber or cotton of Asiatic growth. Our exports of cotton to Japan were highest in 1931-32 at 2,312,000 bales, but in 1937-38 were down to 706,000 bales, or by 69.4 per cent.

Below are given figures for the consumption of cotton by Germany and Italy respectively in each of the four cotton-crop years from 1933-34 to 1936-37, in thousands of bales:

(000's Omitted)

	Germany			Italy		
Year	American	Other	Total	American	Other	Total
1933-34..	1,099	498	1,597	663	242	905
1934-35..	376	578	954	460	354	814
1935-36..	390	745	1,135	425	198	623
1936-37..	240	780	1,020	320	300	620

The falling off of United States cotton in Germany and rise of other cottons chiefly means a substitution of Brazilian cotton. The loss of total cotton consumption in both countries probably is attributable to "staple" or similar fibers.

The development of cellulose fibers is an example of what science is doing in all the industries. None is standing still, and individuals must adjust themselves to the changes. Every step of progress has been disturbing to those who fail to move with it. And so the introduction of machine-production into countries that have had only hand-production in the past is a natural development which cannot be stayed. Japan is trading cotton goods for raw cotton wherever cotton is grown and teaching how to grow it. This is encouraged by restrictions upon the production of American cotton.

The policy of cotton acreage curtailment has aggravated the share-cropper problem. This unfortunate class is being crowded out of agriculture when there is no place for it to go. The South needs a greater variety of industries exchanging products with each other—more of the industries that require capital, and will shift thousands of share-croppers to payrolls. There is no limit to the employment that may be had by exchanging services. It is true that the South is lacking in capital as compared with natural resources, but so was every section of the country earlier in its history.

All Agriculture Affected

Notwithstanding the losses indicated above, cotton exports still take one-half our crop, and are vitally needed. With a carryover greater than the crop, and acreage down nearly half

since 1926, the American cotton farmer is being backed off the map. Moreover, if the South is to continue losing its foreign market for cotton, all sections of this country, and all lines of business will be compelled to make costly adjustments. If Southern farmers are to grow less cotton they must turn to other crops. Men of the South have given warnings. The following is from an editorial in the Chattanooga News of July 14, 1937:

> Obviously there will have to be some kind of transfer of the Southeastern cotton farmer—whether landlord, cash tenant, share tenant, or share cropper—from the raising of cotton to that of some other type of natural production. During this period of transfer there is sure to be an even direr distress than that now existing. For the time being, this increase of distress is being prevented by national policies, the propriety of which need not here be discussed, but the continuation of which cannot be expected indefinitely beause the money might not hold out. Once this national policy of subsidizing the cotton farmer for growing less instead for growing more, comes to an end, the distresses will manifest themselves.
>
> If only there could be provided a long period of years during which the shock of change could be cushioned by the gradual transfer of land and labor from cotton to other crops, we might have some expectation for a substantial decrease of the keenness of these distresses. But things have a habit of happening in a hurry, so that catastrophe comes all at once.
>
> The types of things to which we probably would seek to shift are dairying, livestock and the production of grain. In all these things we will be in competition with the Middle West. This will be distressful from several standpoints. For many years the Middle West was on an export basis. Here recently, due to a combination of bad growing weather, dust storms, and emergency farm policies, she has been on a domestic basis. Should the South lose a substantial part of what remains of her export cotton trade, she is almost certain to shift over to growing things which the Middle West now produces.

Comments on the Cotton Situation

The Cotton Trade Journal, of New Orleans, for the last ten years has published annually an "international edition," which is a comprehensive review of the cotton trade. It is a volume of communications from well-known men of the trade in all parts of the world, published over their own names; also from such men as Oscar Johnston, head of the largest cotton-growing corporation in the South, director of A.A.A. cotton pools, director of the Federal Reserve Bank of St. Louis; Henry C. Taylor, formerly of the University of Wisconsin and Assistant Secretary of Agriculture; A. H. Garside, economist of the New York Cotton Exchange; W. E. Morgan, economist of A. & M. College of Texas; and more than fifty authorities representing every important cotton-producing country and important cotton market in the world. They do not fully agree, but there is a remarkable degree of unanimity upon the main features of the cotton situation.

Southern spokesmen recognize that cellulose fibers are a new factor in the textile situation, that the production of cotton and cotton goods is increasing in Asia, Africa, and Latin America, where wages are low, and that the costs of our own cotton should be reduced. However, they are inclined to urge that our national policy has been to protect American labor from low-wage competition, and that the rule should apply on farms as well as in factories. On the other hand, Mr. Garside, without combatting this principle, points out that protecting our home market against foreign products is one problem, and selling our cotton in foreign markets is a different problem. Economist Morgan, of the Texas College of A. & M., warns that "when the American farmer produces only one of every three bales of cotton grown, he had better revise any ideas about controlling the world price."

Henry C. Taylor's article is entitled "Cotton Curtailment Threatens the Corn Belt." He believes that if Southern farmers are forced out of cotton they will inevitably grow more of the corn belt crops. He tells of an incident which occurred while he was representing the United States Government at the Institute of Agriculture, Rome, Italy, a few years ago:

> While lunching with a cotton spinner in Naples, he said to me: "I prefer the cotton from the United States, but I am using Brazilian cotton." He also told me that he was selling the cloth as made from American cotton. "Is not Brazil in America?" he said.

Almost without exception the comments of foreign contributors are similar to the following from Mr. Charles Wibo, of Belgium:

> In fixing cotton prices at 10c or above since 1933, which was a very attractive price for the producers of other countries, we have seen all the world, even America, making every effort to get a better yield or increase the acreage, and at the same time cotton consuming nations were urging new countries to start cotton cultivation and making every effort to produce more and more artificial fibers.

One of the most interesting of the articles is by a well-known 1,000-acre cotton-farmer, R. B. Snowden, Jr., whose post office address is R. F. D. No. 1, Hughes, Arkansas. His views on cotton restriction and price-fixing are indicated by the following extract:

> I have in my library a reference book about two inches thick. Paradoxically this book is published by the United States Department of Agriculture, Bureau of Economics. It refers to about 3,000 cases in history beginning back as far as 200 B. C. whereby the natural laws of economics, and the laws of the survival of the fittest, were attempted to be influenced by legislative fiats, dictatorial mandates, or what have you, and in this book the failures are listed, and the causes of the failures are listed, and without exception all 3,000 cases are in the failure column except for the immediate emergency.

Mr. Snowden also quotes approvingly the following sentence from an editorial in the London Financial News:

> If the United States does not cease its economic policies in cotton, it will have for the next two or three decades a job of reconstruction greater than that following the Civil War.

It is impossible to quote from more of these communications or even to summarize them at length, but the symposium is valuable to any one concerned in cotton.*

*NOTE: This International Edition (1938) of the Cotton Trade Journal is a fine example of journalistic enterprise. It is printed on calendered paper, 192 pp. 10½ x 15", and one copy weighs 3 lbs. Price per copy: $2.50.

The National City Bank of New York

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Condensed Statement of Condition as of September 30, 1938

INCLUDING DOMESTIC AND FOREIGN BRANCHES

ASSETS

Cash and Due from Banks and Bankers		$ 559,862,182.85
United States Government Obligations (Direct or Fully Guaranteed)		650,371,870.17
State and Municipal Bonds		96,386,724.06
Other Bonds and Securities		115,010,734.14
Loans, Discounts and Bankers' Acceptances		507,011,955.89
Customers' Liability Account of Acceptances		11,439,766.26
Stock in Federal Reserve Bank		3,705,000.00
Ownership of International Banking Corporation (Including Paris Office)		8,000,000.00
Bank Premises		48,942,869.29
Items in Transit with Branches		2,229,045.83
Other Assets		4,128,439.78
Total		$2,007,088,588.27

LIABILITIES

Deposits		$1,836,498,401,36
Liability as Acceptor, Endorser or Maker on Acceptances and Bills	$37,298,944.90	
Less: Own Acceptances in Portfolio	14,952,030.97	22,346,913.93
Reserves for:		
Unearned Discount and Other Unearned Income		3,498,808.37
Interest, Taxes, Other Accrued Expenses, etc		6,549,460.12
Dividend		1,550,000.00
Capital	$77,500,000.00	
Surplus	46,000,000.00	
Undivided Profits	13,145,004.49	136,645,004.49
Total		$2,007,088,588.27

Figures of Foreign Branches are as of September 24, 1938.

$62,914,248.68 of United States Government Obligations and $23,410,717.87 of other securities are deposited to secure $57,732,469.49 of Public and Trust Deposits and for other purposes required by law.

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Condensed Statement of Condition as of September 30, 1938

ASSETS

Cash and Due from Banks	**$ 37,239,225.71**
United States Government Obligations (Direct or Fully Guaranteed)	**30,126,927.99**
State and Municipal Bonds	**7,293,002.15**
Other Bonds and Securities	**15,975,804.60**
Loans and Advances	**7,082,205.96**
Stock in Federal Reserve Bank	**600,000.00**
Bank Premises	**4,166,753.25**
Other Assets	**2,284,035.51**
Total	**$104,767,955.17**

LIABILITIES

Deposits	**$ 77,152,770.41**
Reserves	**2,921,743.19**
Capital	**10,000,000.00**
Surplus	**10,000,000.00**
Undivided Profits	**4,693,441.57**
Total	**$104,767,955.17**

$1,521,361.86 of United States Government Obligations are deposited with public authorities for purposes required by law.

(Member Federal Deposit Insurance Corporation)

PRINTED IN U. S. A.

J. S. A.